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WORKERS' COMPENSATION EMERGING ISSUES: INDEPENDENT CONTRACTORS, CONTRACTOR LICENSING, AND EMPLOYEE LEASING

A Report to the Governor and 54th Legislature

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WORKERS' COMPENSATION EMERGING ISSUES: INDEPENDENT CONTRACTORS, CONTRACTOR LICENSING, AND EMPLOYEE LEASING

A Report to the Governor and the 54th Legislature

from the

JOINT SUBCOMMITTEE
ON WORKERS' COMPENSATION ALTERNATIVES

Prepared by
Susan Byorth Fox, Researcher

November 1994

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Room 138, State Capitol
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James A. Nys - Personnel PLUS!
Drea Brown - Unemployment Insurance Division, Department of Labor and Industry
Chuck Hunter - Employment Relations Division, Department of Labor and Industry
Bill Lombardi - State Auditor's Office
Nancy Butler - State Compensation Insurance Fund

SUMMARY

In fulfilling the requirements of House Joint Resolution No. 33 to explore workers' compensation alternatives and to review the reforms made in the 1993 session, the Joint Subcommittee on Workers' Compensation Alternatives (Subcommittee) brought to light some additional areas of concern. These emerging issues are expected to be raised in the 1995 Legislative Session. The Subcommittee seized the opportunity to educate themselves on the problems, to request and listen to testimony from interested persons, and to encourage interested persons to formulate solutions. This report is a compilation that is intended to give the same opportunity to others. It reiterates the information that the Subcommittee received so that legislators, lobbyists, and other interested persons may access the same information if these issues are raised. There were two issues brought to the subcommittee's attention: problems with the independent contractor exemption and issues with the emerging employee leasing industry. Within the first issue, a solution to license contractors was proposed. Each issue is addressed in a separate chapter.

The state allows an independent contractor exemption for workers' compensation coverage. Its use has been a long-standing concern, but recent in-migration to the state, accompanied by a building boom, has magnified the problems. Representative Vicki Cocchiarella had proposed legislation that failed in the 1993 Special Session (House Bill No. 87) requiring contractors to show proof of workers' compensation coverage in order to get a building permit. She asked the Subcommittee to pursue solutions to the problem of many contractors failing to have workers' compensation coverage on all of their employees by misuse of the independent contractor exemption. It is an area of frustration in the workers' compensation arena. The information that the Subcommittee reviewed is presented in Chapter One. Arising from the discussion of the independent contractor issue, a front-end solution was proposed to license contractors and to ensure that workers' compensation or

equivalent coverage was obtained and that all workers were covered. Chapter Two includes a section on the licensing of contractors.

Within the last decade, there has been an emergence of a new industry in Montana that is generically referred to as employee leasing. A related but different industry, temporary service, has statutory provisions regulating it, but there are no statutes regulating employee leasing, in general, or regulating "professional employee organizations" (PEO), the specific group represented at the Subcommittee and Employee Leasing Working Group meetings. The differentiation among the three types of employer-employee relationships is difficult. The difficulties are experienced by the private companies, the state regulating agencies, and the insurers in determining what is legal or illegal, what responsibilities each entity has to its employees, and what protection each entity has in terms of workers' compensation. Chapter Three is devoted to this issue.

The Subcommittee took an educational approach to these issues and utilized their meetings as a way to bring the respective interested and affected parties together to discuss the problems and potential solutions. The Subcommittee dedicated the August meeting to the independent contractor and the employee leasing issues. The Subcommittee did not have the time to propose or recommend specific solutions to these problems, and additionally, the members believed that it was important for the respective parties to come to a consensus and propose solutions for themselves.

At the final meeting in September, the Subcommittee dedicated a portion of the meeting to gathering information on the licensing of contractors issue and also encouraged the respective parties to work on solutions together.

This report does not present conclusions or refined discussions of appropriate solutions. It presents raw information, basically as it was presented to the Subcommittee members, and it identifies the parties who gave their time and expertise on these issues. It serves the function that the Subcommittee itself

served: to bring forth the concerns regarding these issues in order to educate those who will consider these issues in the future.

Chapter One

INDEPENDENT CONTRACTOR ISSUE

The definition of an independent contractor is in 39-71-120, MCA, which states,

> **39-71-120. Independent contractor defined.** (1) An "independent contractor" is one who renders service in the course of an occupation and:
>
> (a) has been and will continue to be free from control or direction over the performance of the services, both under his contract and in fact; and
>
> (b) is engaged in an independently established trade, occupation, profession, or business.
>
> (2) An individual performing services for remuneration is considered to be an employee under this chapter unless the requirements of subsection (1) are met.

The definitions of employer, 39-71-117, MCA, and employee, 39-71-118, MCA, also have subsections that reference the independent contractor. The definition of the employments covered and exempted in the Workers' Compensation Act, 39-71-401, MCA, delineates those persons who are eligible to apply for the exemption from workers' compensation coverage. Workers' compensation coverage in Montana is mandatory, except for certain employments that are outlined, such as domestic and casual employment, realty brokers, and newspaper carriers. Sole proprietors or working members of a partnership may make an application for the independent contractor exemption.

Applications for the independent contractor exemption are made to the Department of Labor and Industry. The requirements for the exemption are in the Administrative Rules of Montana (24.29.706 ARM). The requirements to show that the applicant is engaged in an independently established trade, profession, or business are:

> (1) evidence the applicant pays social security or unemployment taxes on the applicant's employees or self-employment tax; or

(2) a copy of the applicant's federal or state income tax statement for the most recent period that shows income and expenses for the applicant's business; and
(3) contracts or accepted bid proposals; other supporting evidence such as invoices, business cards, business licenses or permits; and proof of a large, substantial investment in tools, equipment, or knowledge essential to the provision of the applicant's services.

The exemption is valid indefinitely and precludes the applicant from obtaining workers' compensation benefits, though a person could be an independent contractor on some jobs and be an employee on others. As an employee, the person would be eligible for workers' compensation benefits if an employer has workers' compensation coverage and the employee is on the payroll. This creates a loophole that contributes to the problem.

Chairman Harp authorized Representative Cocchiarella to form a working group to discuss the problems and to propose solutions.

INDEPENDENT CONTRACTOR WORKING GROUP

The following is a summary of the discussion and the problems and options that were identified at the June 28, 1994, meeting by the Independent Contractor Working Group (ICWG).[1] Other options may be available. The individuals that participated did not necessarily agree with all of the suggestions, but the options were presented for the Subcommittee's information.

Summary of the discussion of the problem

(1) Employers are avoiding the cost of paying workers' compensation premiums by allowing or mandating that persons who work for them have an independent contractor exemption. This allows those employers to underbid others who are providing workers' compensation for their employees.

(2) The problem extends to other areas, such as state and federal unemployment taxes, social security taxes, and income taxes.

(3) If everyone in a particular industry is not covered under workers' compensation, the rates for that industry are impacted because the premium cost is paid only by those participating in workers' compensation coverage.

(4) Some workers have the independent contractor exemption for many years and then get a job and become covered under workers' compensation without having paid premiums for all the previous years of wear and tear.

(5) There are problems in regulating the proof of workers' compensation or independent contractor exemption status. Many workers who have obtained independent contractor status will file claims for benefits as employees once they are injured ("retroactive" use of workers' compensation). Employers then become subject to the loss experience, and the insurer has to pay benefits for those for whom it has never received premiums. Even when a subcontractor has proof of the independent contractor exemption, a prime contractor is liable for workers' compensation claims if the subcontractor has employees and they become injured.

(6) The construction industry is estimated to be 90% of the problem, but other industries were identified, such as the oil field services industry and timber industry. State agencies also appear to be using the independent contractor status to avoid paying workers' compensation because they are given authorization to spend money on contracted services, but not on full-time employees.

(7) The process of obtaining independent contractor status has more to do with the representation of facts than with the reality of the situation. Documents are easy to create to support independent contractor status, and the status is difficult to disprove and costs the auditors a great deal of time.

Options identified by the ICWG

Option 1

Repeal all independent contractor provisions (e.g., 39-71-117(4)(a), 39-71-118(1)(a), and 39-71-120, MCA) and all exemptions (39-71-401(2) and (3),

MCA). This would require everyone to be covered by workers' compensation insurance. There is still the need to clearly define where liability rests when prime and general contractors and subcontractors are involved.

PROS:

- everyone shares in the cost of workers' compensation
- a level playing field for all bidders is created
- everyone either has workers' compensation coverage or is considered to be an uninsured employer
- cross-referencing for unemployment tax, social security tax, and income tax purposes will be easier
- administrative savings may be experienced if independent contractor status is no longer allowed and those persons who are now involved in administering and investigating independent contractor exemptions could be used for other programs, i.e., uninsured employers' program
- other liability insurance that may be picking up the tab for the independent contractor loophole will be relieved of the burden

CONS:

- many groups who have current exemptions or independent contractor status will oppose: employers involved in nonhazardous work, the self-employed, sole proprietors
- small businesses will claim that they cannot afford the cost of workers' compensation insurance
- state agencies will have to pay workers' compensation on all purchased services
- there may be some additional administrative costs to state government to regulate and enforce (could be offset by administrative savings)
- other insurance coverage of the self-employed may be duplicated
- difficulty may be experienced in verification of "work-related" claims when many workers are unsupervised

<u>Option 2.</u>

Leave the independent contractor exemption, but do not allow persons in the construction industry to obtain independent contractor status and require them to carry workers' compensation insurance. There is still the need to clearly define where liability rests when prime and general contractors and subcontractors are involved.

PROS:

- supported by Montana Building Industry Association
- will make everyone in the construction industry share in the cost of workers' compensation
- will create a level playing field for all construction bidders
- will ensure that premiums are paid for all construction workers for all jobs and will avoid retroactive use of workers' compensation
- will assist in cross-referencing for unemployment tax, social security tax, and income tax purposes
- Department of Labor and Industry may experience administrative savings if independent contractor status is no longer allowed because the construction industry is the bulk of the workload
- eliminates the problem of verifying whether someone is independent or has employees
- could protect the general contractor or homeowner from liability if workers' compensation status and responsibility are defined more clearly
- will simplify enforcement of workers' compensation laws

CONS:

- there may be some opposition from the construction industry
- small businesses will claim that they cannot afford the cost of workers' compensation insurance
- other insurance coverage of the self-employed may be duplicated
- difficulty may be experienced in verification of "work-related" claims when many workers are unsupervised

<u>Option 3.</u>

Delete independent contractor status, but allow additional exemptions to 39-71-401, MCA, by specific industry or trade and better define sole proprietor or self-employed with no employees.

PROS:

- narrows definition for those who can be exempt for specific occupations and makes them ineligible for workers' compensation while performing those functions
- requires each occupation or trade to justify its exemption

CONS:

- could leave loophole and continue the same problems if the process is not improved

Option 4.

At a minimum, the following should be done:

(1) tighten definitions in Title 39, chapter 71, MCA, i.e., independent contractor, sole proprietor, employer, etc.;

(2) require an application and renewal fee for independent contractor status (e.g., equal to minimum premium amount of $200);

(3) increase requirements for exemption, i.e., produce actual copies of contracts and actual proof of tax status or have a workers' compensation policy until proof is obtained;

(4) better enforcement and penalties for those who do not comply and who abuse the exemption as either an employee or employer; and

(5) immunity from workers' compensation or tort liability for those who contract with independent contractors and who have satisfied requirements of verifying the status of independent contractors.

PROS:

- current system will work better
- cost of application fee is comparable to minimum premium, which may encourage the purchase of minimum coverage

CONS:

- would require administrative costs for better regulation and enforcement
- would require clearly defined requirements for exemption or else an employer could use this to get around providing workers' compensation and to avoid liability
- may not resolve some problems

OTHER IDEAS:

(1) Combine options: (a) Option 3 could be used if certain groups want to retain exempt status, but there would be no "independent contractor exemption" process as we now know it (variation on option 1).

(b) If the construction industry is required to carry workers' compensation as in option 2, options 3 and 4 could still be used to improve the "independent contractor exemption" process so that it works better.

(2) Require independent contractors to have medical coverage only.

(3) Set up a red flag for investigation for those with the exemption who file claims.

(4) Require a waiting period or proof of insurance to avoid retroactive use of workers' compensation.

The summary of the June ICWG meeting was presented to the full Subcommittee at the August 1994 meeting. Testimony was taken and Representative Vicki Cocchiarella asked that the points of agreement from the summary and the testimony be summarized and distributed to the members of the working group. The text of the Points of Agreement follows.

POINTS OF AGREEMENT ON INDEPENDENT CONTRACTOR ISSUE

I. The main points of agreement are:

(1) Lack of enforcement of the current rules regarding the independent contractor exemption is a problem.

(2) Clarification is needed on who or what an independent contractor is. (The issues of sole proprietors and limited liability companies are related and must be included if addressed.)

(3) Stronger enforcement provisions are needed (i.e., penalties).

(4) If mandatory workers' compensation coverage is pursued, alternative coverage, such as disability insurance, bonding, etc., should be allowed in lieu of workers' compensation coverage.

II. Other points that seemed to have support but may not necessarily be considered points of agreement were:

(1) If the problem is specifically with the construction industry, only that industry should be addressed in the solution.

(2) Licensing of construction contractors needs to be strengthened from the current board that licenses only public contractors and does not assist in the enforcement of workers' compensation or other employer responsibilities.

(3) The prime contractor should be held ultimately responsible for all parties to be covered, either by workers' compensation insurance or by an independent contractor's exemption. This raises the issue of whether a prime contractor should be held responsible if an independent contractor exemption is abused by a subcontractor.

(4) Consumer protection is a relevant issue that could be dealt with in separate legislation.

(5) A change made in the way the public contract bidding is handled, from the state being the general contractor to the ability to award the contract to a general contractor, may be related and needs to be explored.

The Subcommittee encouraged the interested parties to develop consensus solutions that could be brought to the 1995 Legislature.

ENDNOTES

1. Participants in the Independent Contractor Working Group meeting May 20, 1994. Joint Subcommittee on Workers' Compensation Alternatives, Montana Legislative Council, committee file.

Representative Vicki Cocchiarella, Joint Subcommittee on Workers' Compensation Alternatives
Chuck Hunter, Department of Labor and Industry
Nancy Butler, State Fund
Jim Tutwiler, Montana Chamber of Commerce
Mark Lindsay, Montana Building Industry Association
Don Allen, Coalition for Workers' Compensation Improvement
Harlee Thompson, Montana Building Industry Association
Chris Racicot, Montana Building Industry Association
Dave Cogley, independent contractor

Chapter Two

CONTRACTOR LICENSING

During the August 1994 meeting, a discussion raised the problems related to the independent contractor exemption, especially within the construction industry. Senator Gary Forrester proposed the concept of licensing contractors as in the State of Washington in the construction industry as a front-end solution to some of these problems. Subcommittee staff gathered information from the State of Washington and distributed it to the subcommittee members. The Subcommittee requested that the issue be addressed at the final September meeting.

Representatives from the Board of Public Contractors, the Department of Labor and Industry, the Montana Building Industries Association, the Montana Contractors Association, and private contractors testified. The Subcommittee encouraged them to bring a proposal forth to the Legislature in the 1995 session.

The Subcommittee believed that it must review how contractors are licensed to make sure that the contractors who are truly in the profession are licensed, and to find a way to track licenses to prevent a part of the underground economy that currently exists in Montana.

The following is excerpted from the September minutes[1] regarding the testimony received on the concept of the licensing of construction contractors.

> **Karen Schreder, Licensing and Certification Specialist, Board of Public Contractors, Department of Commerce (DOC)**, said currently the DOC licenses only public contractors (ones who enter into a contract over $5,000 with a public entity). The Legislature gave the power to the DOC to determine the applicant's fitness as a contractor. There are currently 1,900 licensed public contractors, and the money [collected from the] contractors goes into the general fund.

Ms. Schreder said there are existing problems with the licensing aspect of public contractors, and the administrative rules are in the process of being changed. There are no minimum qualifications for public contractors. There is also a great abuse of the public contractor license because of the influx of people coming into the state and the number of homes being built. Everyone is getting a license, whether they are doing public or residential work, because they can advertise that they are licensed. In addition, there is the problem that banks often require a contractor's license when someone is building their own home. A person will buy a $100, Class C license to fulfill the bank's requirement.

At present, the Electrical Board requires that contractors making new applications provide proof of workers' compensation and unemployment insurance and proof of the bond for benefits and wages, and those people who are already licensed must certify that they have them. Ms. Schreder said there has been a great problem with independent contractor exemptions, in that everyone wants to claim them. The DOC is currently trying, through administrative rule, to require proof of workers' compensation and unemployment insurance and the bond for benefits and wages for public contractors just as it did for electrical contractors. However, this would only cover approximately one-third of the contractors in the state.

Ms. Schreder believed that what is needed is a general contractors' licensing law. On a daily basis, the DOC receives complaints about people who are building homes and not doing the construction correctly. The consumer's only alternative is to hire a lawyer because there is no licensing law that enables the DOC to help. In fiscal year 1992, residential home construction [totaled] 2,331 homes. In fiscal year 1994, 3,241 homes were built, which indicates a building boom within the state. The number will increase again in this fiscal year. Out of the 32 states that require statewide licensing, 19 require proof of workers' compensation coverage before the licenses are given.

Ms. Schreder said that most other states have the following requirements, and she believed that Montana's requirements should be the same:

- a completed application;
- a financial statement by a CPA;
- five references (including a bank reference, a bonding reference, and three personal references); and
- both an examination and license fee.

After the application is approved, the applicant must:

- provide proof of workers' compensation;
- provide proof of unemployment insurance;

- provide proof of a bond and public liability insurance; and
- obtain a tax identification number that is registered with Secretary of State's Office.

Ms. Schreder also felt that the best way to administer contractor licensing was through a Board like all other licensing entities.

Senator Bartlett asked what the current fees for licenses were. Ms. Schreder said that there are three classes for licensing: Class C licenses that allow contractors to bid up to $25,000 cost $100; Class B licenses that allow contractors to bid up to $100,000 cost $150; and Class A licenses for unlimited bidding cost $250. These licenses generate approximately $250,000 per year for the general fund.

Representative Hibbard asked if the proposed requirements were meant to be only for public contractors. Ms. Schreder said [yes, but] that the state should require statewide general contractor licensing. Most legitimate contractors want statewide licensing because the DOC receives 10 to 12 requests a day from people moving into Montana from out of state to do electrical, plumbing, or contractor licensing.

Representative Hibbard asked if the requirements would apply if the contractor had no employees. Ms. Schreder said the person would have to be licensed, but could claim an independent contractor exemption if the person could obtain one. They must also provide the letter from the Department of Labor and Industry that actually gives that person the exemption.

Senator Harp asked if the administrative rule changes for public contractors would take care of the issues of workers' compensation, unemployment insurance, and the bond for benefits and wages similar to that of the Electrical Board. Ms. Schreder said she believed the DOC would go with those changes. Senator Harp asked at what point will the rules be in effect. Ms. Schreder said the DOC is trying to have the rules written in the next three months followed by three months of hearings. Senator Harp asked if there was anything the Legislature should do or would the administrative rules take care of the problems. Ms. Schreder said there are some legislative changes that need to be made, but most changes can be done by administrative rule because the DOC has broad rulemaking authority.

Representative Cocchiarella asked if the board had to be set up legislatively. Ms. Schreder said if the DOC continues to go in the path it has been, a new board would not be needed. However, if the DOC were to license all contractors, a new board or changes to the existing board would be needed. Also, the DOC

currently has limited authority for enforcement of discipline over public contractors, and that issue needs to be clarified for both the existing board and any new board.

Chuck Hunter, Administrator, Employment Relations Division, Department of Labor and Industry (DOL), said the DOL believes that the licensing of contractors and of independent contractors may be an effective way of mitigating some of the problems from a workers' compensation perspective. The DOL also believes that more rigid standards are needed than are currently being applied on the exemption process. To fold together the independent contractor exemption process and the licensing requirements for contractors, as well as independent contractors, the DOL would need to begin with all those people who currently have the workers' compensation exemption and start the process over again. This would mean a major workload increase for some period of time, but it would not be ongoing. In addition, if the DOL has a licensing provision that requires bonding, it must be made very clear how the DOL may access those bonds to cover benefits or insurance payments should they need to be made.

Between the DOL and the Department of Revenue (DOR), there has been a task force which has been reviewing the possibility of combining some of their taxation functions, particularly the unemployment insurance taxation and the withholding tax within the DOR. The Task Force has also been investigating the possibility of combining the independent contractor functions from the two agencies into one central unit that would deal with independent contractor issues. One central unit dealing with independent contractor issues for all of state government in connection with a licensing provision would be a step in a positive direction.

Chris Racicot, Montana Building Industries Association (MBIA), said the MBIA has not taken an official stand on contractor licensing or registration. However, it has put together a number of independent contractor issues that includes licensing and registration for the Subcommittee's further consideration. The MBIA has also been in contact with a number of other states and Canada about how different home builders' associations put together independent contractor licensing programs, and it is still disseminating the information.

Carl Schweitzer, Montana Contractors' Association (MCA), said the MCA has also not taken a formal position on whether it agrees with the idea of licensing contractors, although it is finding that many more contractors are interested in the licensing idea. Mr. Schweitzer said that the MCA's Governmental Affairs Committee was impressed with what Nevada does in the area of

licensing contractors in that it is a very complete licensing program. However, Nevada has a large staff with a $2.3 million budget. The MCA is interested in looking at some proposals, but it does not want to see more bureaucracy created. Mr. Schweitzer offered the MCA's help to work with Subcommittee on any solutions to the problems in the construction industry.

Representative Elliott said there are two reasons to license a person. One is to protect the consumer who hires the contractor; and the other is to protect the people in the industry from other people who fraudulently claim to have bona fide credentials as contractors. He asked if licensing would affect the "good guys" in the building industry. Mr. Schweitzer said it could if there are no securities provided for those contractors who are legitimate. Representative Elliott asked if a contractor could require that subcontractors be bonded. Mr. Schweitzer said some contractors do require some bonding by subcontractors, but not all contractors do. Other contractors require payroll funds.

Senator Harp said it is up to the general contractor and what his internal policies are as to whether a subcontractor must be fully bonded or not. ... He felt that loopholes exist with both the MCA and the MBIA; and rather than surprise the two associations with some type of legislation, he asked that the two groups come together and find common ground. If they come up with a few general ideas that can be worked with, they could contact a Subcommittee member to request legislation.

Mr. Racicot said he could also get together with the Department of Labor and Industry, the Department of Commerce, and other interested persons to create some user-friendly solutions. He felt that there may be something that can be done as an industry that cannot be done by the government.

Representative Elliott asked do we let government regulate the industry or do we let the industry regulate the industry? A free enterprise environment wants the industry to regulate itself. If the government is allowed to regulate the industry, then the industry would be hiring the government to regulate its ranks. The general government should not exist to protect industry because industry is capable of regulating itself. It does not need to jump through more government hoops. The business of the government is to protect the consumer from unscrupulous business practices. He asked that this be kept in mind in any deliberations that may go on.

Dave Cogley, Independent Contractor, Helena, said the issue of industries regulating themselves has existed for quite some time. [A consideration of the contractors who supported the idea was

that proposing a board would be misconstrued as protecting turf.]

Senator Harp said that there is no wilder nor more independent entrepreneurial spirit found anywhere than in the construction industry. To try to regulate itself internally is impossible. They will always have to bring in a third party.

Senator Toews asked if there was any organization in the construction industry that was looking at certain ethics for contractors. Mr. Schweitzer said there are ethical standards that exist for the construction industry; however, they have not come into question very much. He said that the MCA is not in the business of enforcing ethics. Mr. Racicot said the MBIA has no ethics laws, but it is something that the MBIA is going to do. He felt it was incumbent on the home building industry to lead the way with good professional practices and make it the fashionable thing to do.

ENDNOTES

1. Subcommittee on Workers' Compensation Alternatives, Minutes, Montana Legislative Council, September 23, 1994.

Chapter Three

EMPLOYEE LEASING ISSUE

Concern over the employee leasing industry was raised at the June meeting. The August Subcommittee meeting agenda was split between the independent contractor issue and the employee leasing issue. Staff conducted a brief review of the statutes to provide background for the Subcommittee. There is currently nothing on employee leasing in the statutes, but employment agencies and temporary service contractors are referenced.

The Employment Agency Act, enacted in 1971, refers to "temporary service contractors" in the definition section, 39-5-102, MCA. Temporary service contractors are defined as "any person, firm, association, or corporation conducting a business which consists of employing individuals directly for the purpose of furnishing such individuals on a part-time or temporary basis to others." Temporary service contractors are not considered employment agencies which assist people in finding employment.

Under the Workers' Compensation Act, the same definition of temporary service contractor is used in 39-71-116, MCA. The term "employer" is defined in 39-71-117, MCA, and subsection (2) states, "A temporary service contractor is the employer of a temporary worker for premium and loss experience purposes". Subsection (3) states that,

> [An] employer defined in subsection (1) who utilizes the services of a worker furnished by another person, association, contractor, firm, or corporation, other than a temporary service contractor, is presumed to be the employer for workers' compensation premium and loss experience purposes for work performed by the worker. The presumption may be rebutted by substantial credible evidence of the following:
>
> (a) the person, association, contractor, firm, or corporation, other than a temporary service contractor, furnishing the services of a worker to another retains control over all aspects of the work performed by the worker, both at the inception of employment and during all phases of the work; and

(b) the person, association, contractor, firm, or corporation, other than a temporary service contractor, furnishing the services of a worker to another has obtained workers' compensation insurance for the worker in Montana both at the inception of employment and during all phases of the work performed.

The term "employee" is defined in 39-71-118, MCA, and subsection (6) states:

> An employee or worker in this state whose services are furnished by a person, association, contractor, firm, or corporation, other than a temporary service contractor, to an employer [as] defined in 39-71-117 is presumed to be under the control and employment of the employer. This presumption may be rebutted as provided in 39-71-117(3). (cited above)

Since there are employees that are not furnished on "a part-time or temporary basis to others", and cannot meet the rebuttal requirements of 39-71-117(3) because "the person, association, contractor, firm, or corporation, other than a temporary service contractor, furnishing the services of a worker to another" does not retain "control over all aspects of the work performed by the worker, both at the inception of employment and during all phases of the work", there is a class of employee leasing firms that are not specifically covered by statute and raise questions for the State Compensation Insurance Fund (State Fund) and the Department of Labor and Industry as to interpretation of the statutes. There exist disagreements between the state agencies and some businesses that do not fit into the "temporary service contractor" definition over statutory interpretation.

Currently in the state, there is an industry that calls itself "professional employer organizations" (PEO). PEOs and the temporary service industry were represented in the meetings. The representatives attempted to differentiate the concepts of employee leasing, temporary service, and professional employer organizations for the Subcommittee. The main issues are the length of employment or how "temporary" the employment is, who has supervisory and personnel responsibilities, what the task orientation is, and who is the employer of record for each employer responsibility.

Professional employer organizations see themselves as co-employers with the client employer. The employer functions are defined by contractual arrangement. The PEO generally handles the administrative and personnel matters, and the client employer (traditional employer) is responsible for the work product or service.

A temporary service contractor is the supervisor and employer of the employee and is responsible for workers' compensation and other employer responsibilities. Employee leasing in general may involve various forms of the other entities. The difficulty in defining the differences between these entities illustrates the kinds of problems that were raised.

Since the full Subcommittee was only introduced to the problems in this area in August, Senator Sue Bartlett volunteered to work with a group of interested persons[2] on this issue. The following is the summary of the Employee Leasing Working Group meeting on August 30, 1994.

SUMMARY OF THE EMPLOYEE LEASING WORKING GROUP

Major interests and concerns in relation to professional employer organization legislation - Senator Sue Bartlett

(1) Identify who is the employer in a professional employer organization (PEO) relationship.

(2) Identify who is responsible for workers' compensation and unemployment insurance coverage in a PEO relationship.

(3) Identify how experience ratings will be handled under a PEO relationship.

(4) Who is responsible to adequately notify the appropriate state agencies that coverage is being terminated under a PEO and client-employer contract (i.e., the PEO or the employer who has been identified as responsible for workers' compensation coverage and unemployment insurance coverage)?

(5) How does the exclusive remedy issue apply in a PEO relationship?

(6) For organized labor purposes, how are unit determinations made if there is an effort to organize workers who are employed under a PEO and client-employer contract?

(7) How is a PEO to be differentiated from a temporary service provider?

(8) Who is responsible for licensing in a PEO and client-employer contract?

(9) How does a PEO and client-employer relationship affect pensions and retirement benefits?

(10) Joint and several liability issues must be addressed.

Who is responsible for workers compensation and unemployment insurance coverage?

The PEO is responsible for all employee related functions of the client location, i.e., workers' compensation coverage, unemployment insurance coverage, and payroll, etc. The client employer is responsible for maintaining the product and service functions of the client location. (Terry Keating -United Staffing of Montana)

Can a PEO and client employer be considered co-employers?

An employee can have two employers. The two employers decide which functions within the client location that they will be responsible for and the recipient agreement states which employer is responsible for which function. (Terry Keating)

If legislation is proposed to identify who the employer is in a PEO and client-employer relationship, who would the working group members like to be named as the employer?

(1) The PEO would like to be the employer of record. (Terry Keating)

(2) The traditional employment relationship (the recipient of the service of the work as the employer) is easiest for the Employment Relations Division of the Department of Labor and Industry. However, the Department is not opposed to looking at a co-employer relationship as long as the proper coverage and proper responsibilities are established. (Chuck Hunter - Department of Labor and Industry)

(3) The risk factor follows the client and stays with the client. If the client does have a high modification factor, the State Fund, as an insurer, can collect adequate premium. If co-employer legislation is proposed, the State Fund would like it to include some protection so that the modification factor follows the individual client. In addition, the State Fund would like to see the proposal address who is responsible for providing safety, access for inspections, and access to records for audits, etc. (Nancy Butler - State Fund)

(4) Plan 2 carriers have the same concerns as the Department of Labor and Industry and the State Fund. The most important issue for Plan 2 carriers is that there be nothing in the proposed legislation that would diminish or impair a proper experience rating. (Jacqueline Lenmark - American Insurance Association)

(5) The State Auditor's Office wants the experience rating to follow the client company*. (Bill Lombardi - State Auditor's Office)

(6) It would be easier for the Unemployment Insurance Division of the Department of Labor and Industry if the client was the employer. It would like the proposed legislation to protect the Employment Insurance Trust Fund. However, the Department would not have a problem with the co-employer relationship. (Drea Brown - Department of Labor and Industry)

(7) The temporary employment industry has always been the employer. They currently are and wish to continue to be the employer for purposes of loss experience for both workers' compensation and unemployment insurance. The industry is also concerned that the definition adopted for PEOs does not prohibit the temporary employment industry from doing business. The definitions used in both the model acts proposed by the PEOs and the National Council on

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* New Mexico and Rhode Island have abolished their professional employment organizations because the modification factor did not follow the client company.

Compensation Insurance (NCCI)* are fine with the temporary employment industry. However, it prefers the definition proposed by the NCCI Model Act as opposed to the PEO's Model Act. (Jim Nys - Personnel PLUS!)

According to testimony at the July 19, 1994, meeting, persons representing the PEOs indicated that they would not have a problem with identifying, for experience rating purposes, the clients as employers and having their experience rating follow them even after they contracted with the PEO. The representatives also stated that they may want to modify the modification rate as the State Fund would. If a client's modification rate is adopted by the PEO, the rate is not in concrete because the client's experience could change thereby changing the modification rate accordingly, as it would in the normal course of business. In addition, some private insurance carriers will allow the client location to adopt the modification factor of the PEO and the policy is underwritten on that basis.

How does the exclusive remedy issue apply in a PEO relationship?

John MacMaster, Staff Attorney, Legislative Council, said the Montana Constitution states that there is a court remedy for any wrong that is done, except to the extent that the employer has provided an employee with workers' compensation. If the PEOs are going to be called co-employers, the question becomes, which of the employers (the PEO or client employer) has to provide workers' compensation insurance? Regardless of whom the rule applies to, is it fair to say that the employee can sue the employer that does not provide the workers' compensation coverage? The PEOs want the exclusive remedy concept to apply to both the PEO and the client employer. Most states are split on how they have provided the exclusive remedy concept in the law.

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* The National Association of Insurance Carriers has proposed an Employee Leasing Registration Model Act, supported by NCCI, that differs from the legislation proposed by the PEOs.

It was Mr. MacMaster's opinion that the PEO industry was setting up a "legal fiction" (assume something to be true, when, in fact, it does not exist). He believed that the client was the employer and the only employer. However, legislation could be drafted that addresses the concerns of the PEOs, the State Fund, and the Department of Labor and Industry and still allows PEOs and clients to contract with one another. Appropriate protection should also be provided by law for health insurance and retirement funding. A PEO is a contractual servant of the client employer. Mr. MacMaster had no problem saying that the exclusive remedy provision could cover the PEO as well as the client employer. However, the legislation should include specific language stating that both the PEO and client employer are covered by the exclusive remedy provision.

Terry Keating, United Staffing of Montana, said there are three separate nontraditional employer and employee relationships. A temporary employment worker comes from one work site to another work site for a short period of time. Employee leasing is an extension of that for a longer period of time, but its workers also come from one work site to another work site. Typically, the period of time spent by the employee leasing firm employee is governed by the task performed. A PEO does not bring or send people out to a work site. The PEO takes the existing long-term work force and co-employs with the client employer.

Jim Nys, owner of Personnel PLUS, Inc., stated that part of the confusion is that the three different definitions of leasing firms have not been used in statute. The term leasing has been used in other jurisdictions and the question then becomes how long-term can a temporary assignment be before it becomes something else, and what does it become when it hits that point?

Is there enough distinction between the three definitions that they would need to be addressed in statute as opposed to distinguishing only between temporary services and the PEO approach?

Mr. Keating said yes, there are three distinct activities and three distinct employer and employee relationships.

Mr. Nys said there are federal statutes that have recognized the co-employment concept, such as the Family Medical Leave Act. There needs to be an equivalent concept under state statutes. He is not convinced, however, that there need to be all three definitions, but there need to be at least two of the three definitions.

Howard Recht, Attorney, United Staffing Alliance, said the Alliance is interested in legislation to provide a framework for the PEO industry in Montana. The proposed legislation is a licensing and regulation statute designed to ensure that the companies that do business in the PEO industry meet certain criteria including financial credit worthiness and compliance with workers' compensation and unemployment insurance.

The workers' compensation scheme was enacted to benefit the employees. In a co-employment relationship, the argument can be made that either the PEO or its client employer is the employer for workers' compensation insurance. If there is more than one person employing, each entity needs to be protected to make sure that it is not considered an uninsured employer in the event that an employee is injured. The proposed legislation includes that the PEO shall be entitled, along with the client, to the exclusivity of the remedy under both workers' compensation and employers' liability provisions that either party has secured. Additional language also needs to be added that states that neither the PEO nor the client shall be deemed an uninsured employer within the meaning of 39-71-501, MCA, or subject to a cause of action as provided in 39-1-508 or 39-1-515, MCA, or subject to a limitation of defenses as provided in 39-1-509, MCA.

Mr. Recht added that the need to identify who the employer is in statute would pose a problem in the PEO point of view. It is his opinion that a different type of worker is being created than has existed before. Rather than trying to

identify an exclusive employer, there needs to be a provision whereby the obligations and liabilities that arise out of the employment relationship are assigned and in place. The proposed legislation requires the PEO and client employer to enter into a written contract which spells out who is responsible and liable for what when the employment relationship is considered. The whole key to the PEO industry is that there is a sharing of the responsibilities that otherwise fall on the small business employer. If the legislation states that the PEO or client employer is the exclusive employer, it undermines the ability of the small business owner to use management skills and techniques to deal with the problem of being a small business owner. It would also take away the opportunity to have a PEO help a small business in that capacity.

How many client contracts identify the PEO as responsible for providing workers' compensation coverage?

Different states have different laws dealing with workers' compensation insurance. The majority of PEO customers maintain a workers' compensation policy in the name of the customer business with the PEO as an additional insured to ensure that the underwriting focuses on the particular client business and not the PEO company as a whole. The PEO helps the client obtain a workers' compensation policy, and the policy is in the client company name. The PEO administers the funds and helps to investigate the claims, but a separate entity is contracting with the PEO client to create the insurance relationship. Ultimately, it is the client who is responsible for workers' compensation coverage. (Howard Recht)

Mr. MacMaster asked if this could still be done if the statute said that for purposes of a PEO relationship with a client, the client is the sole employer. Mr. Recht said no because the foundation of the relationship would be changed. There are IRS considerations, federal statute considerations, and a PEO must be able to participate in the ultimate right to hire and fire. In addition, if the PEO was not involved in the workers' compensation coverage and did not have

the indemnity portion of the coverage, they would be subject to a lawsuit as an uninsured employer. The proposed legislation reflects this aspect.

Would the State Fund and the Plan 2 Insurers need to rely on each individual contract to identify who will be carrying the workers' compensation insurance?

Looking at each individual contract would be the only way the state would know who is carrying the workers' compensation insurance. Some states require that a PEO report its clients. It is not necessarily required by legislation but by administrative rule. (Howard Recht)

Has there been any precedent in other states where a PEO arrangement has gone bad, legal action was taken, and the client employer has borne the brunt of the action for not providing workers' compensation? (Jim Tutwiler)

There have been PEOs that have walked off with the money and left employers holding the bag. In situations where there is a good PEO and the client relationship is ongoing, there have been suits in which an injured worker had brought before the court the issue of exclusive remedy extending to the PEO. It is the trend of the court to extend the exclusive remedy protection to the PEO from the traditional employer when there has been no state statutes to give the court direction. (Howard Recht)

If the PEO has the workers' compensation coverage, is the exclusive remedy extended back to the client employer? (Carl Schweitzer)

In some instances, there is an organization that is like a long-term temporary service. The employees are more employees of the PEO and are being leased for a particular long-term job assignment. The PEO covers those employees with its workers' compensation insurance and extends the coverage to the client employer and its job site. (Howard Recht)

Who is responsible for the violations of the federal Occupational Safety and Health Act (OSHA)? (Carl Schweitzer)

The recipient contract contains a delegation of responsibilities and allocation of liability for all such issues. The responsibility could lie with either party. However, most typically, the client customer maintains the responsibility to comply with any safety requirements. (Howard Recht)

What if the proposed legislation identifies that these obligations are to be based on the individual PEO and client-employer contracts?

As the regulatory body, the Department of Labor and Industry must be able to interpret the contract as to who is responsible for what. This is a very difficult situation unlike current law that firmly fixes the liability in one place and one place alone. It also has the potential of entering into the realm of contract dispute that needs to be resolved through the court system before the liability is firmly pinned down. (Chuck Hunter)

The State Fund has the same concerns. Every contract would have to be looked at to make sure the right parties are covered in the right fashion. It also raises the concern that people have a tendency to not always follow a contract. Factual disputes may erode the actual contract that was thought to be. (Nancy Butler)

In a PEO and client-employer relationship, obligations are fully enforceable as they exist under the law. The PEO provides additional resources to deal with those obligations and the liabilities that result. It does not interfere with the state or federal government to enforce these responsibilities. The client employer can look to the PEO for assistance, but they cannot dodge the cause of action as a result of the contract. (Howard Recht)

Do other states have provisions to require that a contract be submitted within so many days to the insurance carriers? (Senator Bartlett)

Utah requires that the model contract be submitted to the state and that the PEO tell the state who its customers are. However, every state does things differently. Concerning safety issues, officials in Utah did not like the PEO doing safety inspections because they had their own people doing them. As time went by, they allowed the PEO to do the inspections. Nevada, on the other hand, requires the PEO to do the inspections and goes to some lengths to provide state sponsored instruction to the PEO people on how to do the inspections. (Howard Recht)

Have Utah and Nevada written their statutes in such a way as to accommodate co-employers and could their statutes be looked at as model legislation for Montana? (Senator Bartlett)

Utah and Nevada statutes state that co-employer relationships can exist. Some states are very limited as to what their legislation states. Montana statues need to be more specific as to the licensing and registration of the PEO industry as opposed to just stating that a co-employer relationship can exist. (Howard Recht)

Can a model contract between a PEO and client be provided for the working group? (Senator Bartlett)

A model contract can be provided with the caveat that since the contract would be the one used by the Allied Staffing Alliance only, there is no authority to say that this contract is used across the board by all PEOs in the industry. (Howard Recht)

What approach can the working group take to address the issue of licensing? (Senator Bartlett)

The proposed legislation provided by the National Association of Professional Employment Organizations (NAPEO) is model licensing legislation. The model also, in the context of definitions within the licensing issue, talks about specific

issues such as the employer and employee relationship and who shall be deemed the employer for one purpose or another. The Department of Labor and Industry believes that if there is legislation proposed around leasing organizations and the PEO industry, licensing should be a part of it. There have been agency discussions as to which should be the responsible agency for licensing. Some believe the Department of Commerce should be the responsible agency because it is already set up with these types of boards and commissions. Others believe that there should be a labor-related organization like the Department of Labor and Industry that knows the issues from a regulatory perspective. (Chuck Hunter)

What is the approach to licensing under the NAPEO proposed legislation? (Senator Bartlett)

The NAPEO model legislation has an option either to choose licensing under a state agency or to have a board that has representation in the industry. The proposed legislation will propose the option of the board as the better way because the PEO industry is so new that it needs to be able to put people on the board that understand the industry. (Howard Recht)

It was Mr. MacMaster's opinion that the board option for licensing was not the best option. He is the staff attorney for the Administrative Code Committee and, in that capacity, has worked with the boards through the Professional and Occupational Licensing Division of the Department of Commerce. Forty percent of the state agency problems that have come before the Committee have come from the professional and occupational licensing boards. He believed that the boards do not work because they are too overprotective of the people whom they are supposed to be licensing and regulating.

The Department of Labor and Industry would reluctantly say yes to the PEOs being licensed by their agency. However, the Department's interests would be satisfied to have a representative as a member of the board if one were proposed. (Chuck Hunter)

Bill Lombardi, State Auditor's Office, said that Arkansas put the licensing of PEOs in the Property and Casualty Division of Arkansas Insurance Department.

One concern discussed at the August 19, 1994, meeting of the Subcommittee was the potential for a PEO to self-fund for workers' compensation purposes. Representatives from the United Staffing Alliance indicated that they would not object to a provision that prohibited PEOs from self-funding for insurance purposes because they felt that it was not a good idea to self-fund. However, the proposed legislation does not attempt to change Montana law which provides that any company, if they meet certain criteria, can self-insure for workers' compensation purposes. (Howard Recht)

Representatives of United Staffing of Montana said that Montana has a strong self-insured entity and the option should be left open. (Terry Keating)

What are the provisions in the PEO and client-employer contract for unemployment insurance?

The client customer is responsible for unemployment insurance under a PEO and client-employer contract. If there is a situation where the client employer wants to let an employee go for some reason and if the PEO can find employment for that person within another organization that the PEO is doing business with, the opportunity is given to them. If, however, there is no opportunity and the employee is laid off, the PEO administers those funds and makes sure that the unemployment insurance gets paid. (Howard Recht)

Further information requested for Working Group review

(1) A contract between the PEO and client employer. (unavailable)

(2) A copy of the model legislation from NAPEO in relation to the bill draft request for Montana*.

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* The NAPEO model legislation is retained in the Subcommittee file and the specific language included for the initial bill draft request will be retained in the bill draft request file of the Montana Legislative Council.

(3) The approaches that each working group member would like to see the proposed legislation to take that addresses each of their concerns (i.e., identification of the employer and how they would like to see the responsibility for workers' compensation coverage to be fixed). (See Appendix.)

(4) That the existing language in statute on temporary agencies be eliminated or superseded by the definition that may be in the PEO proposed legislation. (See Appendix.)

Senator Bartlett said that it was her opinion that PEOs offer an opportunity that would be of great benefit to some small employers in the State. However, there needs to be licensing and regulations and the issues that have been identified need to be addressed. The working group has the opportunity to settle differences prior to the legislative session. She asked that the working group provide information on each entity's specific concerns to staff before September 14, 1994 (see Appendix). She anticipated that the outcome of the working group would be that the information would be made available to the full Subcommittee and all interested persons so that if legislation is proposed, the differences that may create dilemmas within the legislative process will have been identified beforehand.

SUBCOMMITTEE CONCERNS FOR PEO LEGISLATION

At the final meeting on September 23, 1994, the Subcommittee requested that the following list of PEO issues that will need to be addressed in any introduced legislation be included in this final report[3]:

- identification of the party responsible for notifying the appropriate agency when a new PEO and client-employer contract is signed, when it is terminated, and who is responsible for submitting reports and payments (the PEO should be the responsible party for providing the notice);

- specify that each client employer and its employees be kept as a separate and identifiable unit in the records, for unemployment insurance and workers' compensation purposes, so that the history of experience ratings and modification factors follow that client-employer and do not blend into an overall unit of PEO employees;

- provide for joint and several liability and exclusive remedy for both the PEO and the client employer;

- provide that both the PEO and client records be subject to audits;

- provide that sole proprietors and partners are not entitled to unemployment insurance coverage and are not eligible for unemployment insurance benefits, even if they become "leased" employees through a PEO;

- provide that both the PEO and client/employer be mutually responsible for ensuring compliance with the Safety Culture Act;

- provide language that would allow the State Fund to refuse coverage under certain circumstances: insured PEO seeks coverage for a client or any of the client's principals who have unpaid obligations to the State Fund; or coverage is sought only for part of the client's workforce (the leased or the nonleased employees only);

- provide language that would make PEOs ineligible to self-insure in Montana (experience in this area is needed before they are allowed to self-insure); and

- clarification of the definitions of "temporary service provider" versus "employee leasing" providers.

Other issues the Subcommittee identified as not within the purview of the Subcommittee but that need to be addressed in any proposal are: (1) whether the licensing authority for PEOs would be better placed in the Department of Labor and Industry or with the Professional and Occupational Licensing Bureau within the Department of Commerce; (2) protection for leased employees' health insurance benefits and pensions when a PEO relationship is made; and (3) identification as to what would be considered an employee collective bargaining unit in a PEO and client-employer relationship.

lao 4320sfxa.

ENDNOTES

2. Participants in the Employee Leasing Working Group meeting August 30, 1994. Joint Subcommittee on Workers' Compensation Alternatives, Montana Legislative Council, committee file.

Senator Sue Bartlett, Joint Subcommittee on Workers' Compensation Alternatives
Jim Tutwiler, Montana Chamber of Commerce
Jacqueline Lenmark, American Insurance Association
Sandra Bay, Department of Labor and Industry
Carl Schweitzer, Montana Contractors' Association
Terry Keating, United Staffing of Montana
Fred Koenig, Department of Labor and Industry
Jim Nys, Personnel PLUS, Inc.
Dennis Zeiler, Department of Labor and Industry
Chuck Hunter, Department of Labor and Industry
Howard Recht, United Staffing Alliance
Bill Lombardi, State Auditor's Office
Nancy Butler, State Fund
Drea Brown, Department of Labor and Industry

3. Subcommittee on Workers' Compensation Alternatives, Minutes, Montana Legislative Council, September 23, 1994.

APPENDIX

Personnel PLUS!, Inc.
Temporary and Permanent Employment

Personnel PLUS! COMPANIES

Personnel PLUS! Business Services, Inc.
Personnel and Management Consulting

September 8, 1994

Senator Sue Bartlett
C/O Susan Fox, Researcher
Legislative Council
Capitol Building
Helena, MT 59620

Dear Senator Bartlett:

As requested, I am submitting proposed changes to both current statute and the model bills proposed by the representatives of the employee leasing firms who are involved in the work group which met recently.

The temporary industry is interested in a definition of temporary employees and/or the temporary industry that does not impair its ability to carry on the business it has developed in Montana. After considering definitions used by other states and those contained in both model bills distributed at the last work group meeting, I believe language based on the model definition proposed by the National Association of Temporary Services is the best to use. The definition is as follows:

> A Temporary Service Contractor is a firm or individual that hires its own employees and assigns them to clients to support or supplement the client's work force in work situations including, but not limited to, employee absences, skill shortages, seasonal workloads, special assignments and projects.

The preference of the temporary industry would be to draft and submit a bill that corrects the language currently in statute. I have attached a list of the major provisions of such a bill. It is our belief that a separate bill is required since the model bills do not speak to cleaning up current language in the work comp act and since there is reason to believe such a bill may not pass this session at all. Since our concerns are not the same as the leasing industry, we would appreciate your and the committee's support and sponsorship of a separate bill.

If the interim committee (or another member of the legislature) should submit a bill to license or regulate the leasing industry similar to the two models given out at the last meeting, we would like to make sure the definition used to define leasing and "temping" do not create new problems. I have attached suggested amendments on the two models as well.

I have sent copies of these proposals to Chuck Hunter and John King as well as to representatives of the leasing industry for their review.

Sincerely,

James A. Nys
President

1802 11th Avenue Suite A Helena, MT 59601 (406) 443-7169 fax (406) 443-5803

ELEMENTS OF A BILL TO AMEND CHAPTER 323 LAWS OF 1991 TO CHANGE THE DEFINITION OF TEMPORARY SERVICE CONTRACTOR AND TO DELETE THE DEFINITION OF TEMPORARY EMPLOYEE IN THE WORKERS' COMPENSATION ACT.

1. Amend section 39-71-116(27) as follows:

Temporary Service Contractor means any person, firm, association, or corporation conducting business that ~~employs individuals directly for the purpose of furnishing the services of those individuals on a part-time or temporary basis to others~~ hires its own employees and assigns them to clients to support or supplement the client's work force in situation including, but not limited to, employee absences, skill shortages, seasonal workloads and special assignments and projects.

2. Delete 39-71-116(29) entirely.

3. Immediate effective Date

PROPOSED CHANGES TO PROFESSIONAL EMPLOYER ORGANIZATIONS ACT (SUBMITTED BY HOWARD RETZ)

Amend Section 4 (I)(3) (a) to read:

Business relationships between Temporary Service Contractors (as defined below) and their clients.

Amend Section 4 (J) to read as follows:
Temporary Service Contractor means any person, firm, association, or corporation conducting business that hires its own employees and assigns them to clients to support or supplement the client's work force in situation including, but not limited to, employee absences, skill shortages, seasonal workloads and special assignments and projects. Services performed by employees of Temporary Service Contractors are not considered Professional Employer Arrangements.

A new section amending or deleting the definitions of temporary contractor used in 3-71-116 (27) and (29) is needed so as to not have two different definitions of temporary service contractor in statute.

PROPOSED AMENDMENT TO EMPLOYEE LEASING MODEL REGULATION (NCCI PROPOSAL)

Section 3 (A) Amend the final sentence which begins with Temporary help service...

Temporary help service means a service whereby an organization hires its own employees and assigns them to clients to support or supplement the client's work force in situation including, but not limited to, employee absences, skill shortages, seasonal workloads and special assignments and projects.

DEPARTMENT OF LABOR AND INDUSTRY
UNEMPLOYMENT INSURANCE DIVISION

MARC RACICOT, GOVERNOR

STATE OF MONTANA

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September 13, 1994

Susan Fox
Legislative Council
Workers' Compensation Interim Committee

Dear Ms. Fox:

As requested in the interim committee meeting of September 23, 1994, enclosed are the concerns of Unemployment Insurance for legislation on employee leasing firms.

If you have any questions, please feel free to call Sandy Bay, Program Manager of UI Contributions at 444-3686 or me at 444-3404.

Sincerely,

Drea Brown

Drea Brown
Status Section Supervisor
444-3404

"AN EQUAL OPPORTUNITY EMPLOYER / PROGRAM"
AUXILIARY AIDS AND SERVICES ARE AVAILABLE UPON REQUEST TO INDIVIDUALS WITH DISABILITIES.

WORKERS' COMPENSATION INTERIM COMMITTEE
EMPLOYEE LEASING LEGISLATION

UNEMPLOYMENT INSURANCE DIVISION
DEPARTMENT OF LABOR AND INDUSTRY

As requested at the September 23, 1994 meeting of the Workers' Compensation Interim Committee, the following are concerns the Unemployment Insurance Division would like to see addressed by employee leasing legislation.

Identifying the employer -

Unemployment Insurance would look at the professional employer-organization (PEO) or the employee leasing company to be the employer if certain conditions were met. It needs to be shown by contract, and in fact, that the PEO is responsible for hiring, firing, supervision, setting pay rates, personnel issues, etc. The PEO will need to be more than acting as a payroll agent.

UI would like to see the following provisions in the law to assure the payment of UI taxes and proper responsibility for claimants' benefits:

- Licensing of PEO/leasing companies - Many states have proposed licensing for employee leasing companies because of past experiences with the leasing firm going out of business, filing for bankruptcy or failing to pay taxes on time. These states feel that as a protection to the worker and the state, it is necessary to regulate the industry and try to assure that unscrupulous firms are not allowed to operate. There is a need for minimum and uniform standards that all leasing firms must meet to conduct business.

- Bonding of PEO/leasing companies - Leasing companies customarily have few tangible assets such as buildings, equipment, inventory, etc. In the event of the failure of the leasing company's business, this will ensure the collection of unpaid taxes. It will require leasing companies to post a surety bond.

- Listing of client companies and employees working for each client - If the leasing company did not pay taxes, UI could determine the wages attributable to each client company by requiring the PEO to provide a list of employees by client each quarter. As it appears the contract may be terminated immediately if the client company does not pay the PEO, it would be necessary for UI to determine the wages and employees associated with each client company. This will allow the department to determine which company the individual was associated with should a claim be filed.

o Immediate notice by the leasing firm to UI of termination of a client - Notification will allow UI the time necessary to contact the former client company, establish their account and obtain employee wages and taxes.

o Joint and several liability - This will assure the payment of taxes should the leasing company not pay.

o Sole proprietors and partners could not be reported to UI as employees of the leasing firm. Current statute provides that sole proprietors and partners of a business cannot report their wages to UI. This exemption was enacted as there is great potential for abusing the UI benefits program. The opportunity for abuse is also present when a sole proprietor or partner is reported as an employee of the leasing firm. The sole proprietor or partner could terminate the contract with the employee-leasing firm and then claim benefits stating they were no longer employed and not making self-employed a full time occupation. In reviewing legislation enacted by other states, the vast majority of states provide for a similar exclusion of sole proprietor and partners wages.

o Corporate officers will report wages under the client company's unemployment insurance account - For UI purposes, corporate officers are viewed as employees of the corporation. As one case from New York stated, "The two corporate officers are the sole shareholders. Their services are being rendered for the benefit of the corporation which they own and not for the benefit of A (the leasing firm). It strains reality to take the position that they are subject to the direction and control of A."

Responsibility for UI taxes -

The PEO will be liable for taxes, penalty and interest. It will also be necessary to have joint and several liability with the client company. By making both parties to the contract liable, it will insure payment of UI taxes.

Experience rating -

Currently, a PEO receives a UI "new employer" rate based on the industry where the majority of their employees are working. New PEO's registering with UI often do not have their client base established. It is very difficult for UI to determine the industry in which the majority of their workers are placed since many of the PEO's registering with UI do not have their clients established. Therefore, the PEO's will be assigned the unclassified new employer rate.

For the remaining years that the PEO has a new employer rate, the company will be contacted each year to determine the industry in

which the majority of their workers are placed. They will then receive the new employer rate for that industry.

After the first year of reporting to UI, the PEO can be assigned a deficit rate (as with any other business). The deficit rate is assigned if a business has more benefit charges to their account than the amount of taxes they have paid into the trust fund.

In drafting legislation, it will be necessary to define "employee leasing" and "professional employer organization". In the Workers' Compensation Interim Committee meeting, the common definition of employee leasing was termed "professional employer organization" and a new definition of "employee leasing" was presented. So that there is no confusion, it will be necessary to define the industry we are attempting to regulate.

DEPARTMENT OF LABOR AND INDUSTRY
EMPLOYMENT RELATIONS DIVISION
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RECEIVED
SEP 14 1994
MONTANA LEGISLATIVE COUNCIL

MEMORANDUM

TO: Susan Fox
Legislative Council

FROM: Chuck Hunter
Employment Relations Division

DATE: September 14, 1994

SUBJECT: EMPLOYEE LEASING

This memo is to fulfill the request of Senator Bartlett to outline the position of the Employment Relations Division on the subject of employee leasing. This memo is the simplified "bullet" summary, but note that I have attached a more thorough listing of our concerns and proposals in a separate memo.

EMPLOYEE LEASING

ISSUE: Constitutionality of "Co-employment"

The Montana constitution may prevent a co-employment concept in workers' compensation. In specific, Article 2, section 16 talks about the exclusive remedy in terms of the "immediate employer".

DOLI Proposal:

That for the sake of the exclusive remedy, and for clarity of liability that the employer who receives the service of the employee be considered the employer.

ISSUE: Licensing

DOLI Proposal:

We believe leasing firms and PEOs should be licensed under the regulatory authority of the Department of Labor and Industry.

ISSUE: Joint and Severable Liability

DOLI Proposal:

If there is to be any sharing of WC liability or accountability that the leasing company and the client company be held joint and severably liable for premium, benefits and penalties.

ISSUE: Reporting and Experience

DOLI Proposal:

Leasing companies should be required to separately account for and report on each client, and maintain a separate experience rate or mod for each client. Leasing companies should also be required to provide timely lists of additional clients or clients who are dropped.

ISSUE: Temporary Employment/Leasing

DOLI Proposal:

We believe that a clearer definition of "temporary" is needed, but it should be very carefully drafted. We have no specific proposal at this time.

ISSUE: Self-Insurance

DOLI Proposal:

We suggest leasing companies be barred from becoming self-insured for WC purposes.

ISSUE: Legislation

DOLI Proposal:

We believe a leasing bill is absolutely essential to bringing order and clarity to this employment area. We hope for legislation that clearly defines liability, protects both employers and employees, and provides for sensible regulation - not for legislation that leaves the worker, the employer, and the regulators in doubt as to where employment responsibilities exist.

DEPARTMENT OF LABOR AND INDUSTRY

EMPLOYMENT RELATIONS DIVISION

MARC RACICOT, GOVERNOR

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STATE OF MONTANA

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HELENA, MONTANA 59604-8011

MEMO

TO: Susan Fox, Researcher
Montana Legislative Council

FROM: Chuck Hunter, Administrator
Employment Relations Division

DATE: September 14, 1994

SUBJECT: Employee Leasing

At the August 30, 1994, special sub-committee meeting on employee leasing, we agreed to provide information stating our preferred approach to the issues to be addressed by legislation. Our list of issues includes:

* Licensing
  - approval and certification by the department
  - application and renewal fees
  - provisions for suspending and revoking license
  - proof of solvency
  - security deposit requirements
  - proof of coverage
  - maintain an office and staff in Montana
  - maintain records in Montana
  - maintain separate records for leased workers and temporary worker services
  - licensed to do business in Montana (legal entity in Montana)
  - notification of leasing arrangements to employees on rights, benefits, etc.

* Clearly Identify Employer
  - Provide that the employer who is utilizing the services of the worker is the employer for workers' compensation purposes in employee leasing arrangements

* Responsibility for Workers Compensation Insurance Coverage
  - Provide that in leasing arrangements the employer who is utilizing the services of the worker is the employer for workers' compensation purposes and obtains the coverage.
  - If the leasing company is allowed to obtain the coverage:

+ State Fund or private coverage only
+ No self-insurance
+ Provision for insurer to receive proper premium (experience rating and modification factor)
+ Leasing company responsible for providing coverage for all employees of clients, not just leased workers

* Exclusive Remedy
  - Provide that in leasing arrangements the employer who is utilizing the services of the worker obtains the policy and has the protection of exclusive remedy
  - If the leasing company is allowed to obtain the coverage, both the employer and the leasing company should have the protection of exclusive remedy

* Joint and Severable Liability
  - Employer and leasing company should have joint and severable liable for:
    + unpaid premium
    + unpaid benefits
    + penalties

* Penalties
  - Operating without a license
  - Operating without proper coverage
  - Violations of licensing requirements
  - Violations of workers' compensation law

* Reporting
  - Leasing company monthly reports to department listing new and cancelled clients
  - Leasing companies notify department of signed agreements with clients within 10 days.
  - Insurers maintain and report information separately to NCCI and ERD for each client

* Organized Labor

* Temporary Employment Agencies
  - Provide for a clearer definition of "temporary employee"
    + written contract which states the period of time the worker will be provided
    + worker provided to temporarily replace an absent permanent worker who will return to work, to temporarily fill a professional skill shortage,

to staff a special assignment or project where the temporary worker will be terminated at the end of the project; or if part of the employer's employment overall selection program, situations where workers must successfully complete a probation period.

If you have questions or concerns about any of the information we have provided, please do not hesitate to contcat me at 444-1555.

STATE AUDITOR
STATE OF MONTANA

Mark O'Keefe
STATE AUDITOR

COMMISSIONER OF INSURANCE
COMMISSIONER OF SECURITIES

TO: SUSAN FOX, LEGISLATIVE COUNCIL
FROM: BILL LOMBARDI, STATE AUDITOR'S OFFICE
RE: WORKERS' COMPENSATION, EMPLOYEE LEASING, PEOs

Phone discussion with Carol Stiffler, Rates and Form Analyst
Arkansas Insurance Department
(501) 686-2981

HOW ARKANSAS HANDLES EMPLOYEE LEASING

- Arkansas' law took effect November 1, 1993.
- Employee leasing firms must obtain a license.
- 15 to 20 are up for licensure now.
- Employee leasing firms have to provide client list, which is deemed proprietary.
- Have to give name of corporate officers or owners.
- Have to provide payroll form for client company and leasing firm. This has been biggest hangup: client companies declining to provide payroll form.
- Department also requires leasing firms to provide $50,000 surety bond, deposit of cash or letter of credit, or an audited financial statement that its net worth is not less than $100,000; this provides financial assurance to department.
- Can license leasing firms or firm groups, but no more than five firms allowed in a group (presumably they can financially guarantee one another).
- For liability purposes, department requires last five years of work-comp history for firm and client companies. If proposed legislation is passed, client company's work-comp experience (experience modification factor) would follow it.
- Recommends that states use the National Association of Insurance Commissioner's model act's multiple coordinated policy basis so can track client company and leasing firm.
- In Texas, leasing firm has own policy and each client company has experience attached: firm tracks client company.

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STATE FUND MONTANA

STATE COMPENSATION INSURANCE FUND
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General Information (406) 444-6500

September 15, 1994

TO: Senator Sue Bartlett
Susan Fox, Legislative Council

FROM: State Fund
Contact: Nancy Butler, General Counsel

RE: EMPLOYEE LEASING

Following is the State Fund's position regarding employee leasing and approaches regarding potential legislation in this area.

The State Fund prefers the current statutory structure regarding temporary workers' and leasing situations encompassed in Sections 39-71-117 and 118.

The reasons for preferring the current statutory structure are the following: 1) it is clear who is responsible for coverage and premiums; 2) it is also clear who retains the loss experience; 3) and it can then be determined who gets the benefit of the exclusive remedy provisions.

However, the State Fund is sensitive to the fact that the leasing of employees is growing and fills a business need in providing worker options to employers. We urge the exploring of legislation that is mutually beneficial for the employers of Montana as well as for insurers.

The State Fund understands that an approach to addressing the leasing situation in Montana will be to request legislation making both the client employer and the contractor co-employers for workers' compensation purposes. We have expressed concerns regarding the exclusive remedy provisions and whether or not both employers will then be able to utilize the protections of the exclusive remedy provision. Right now Montana's statutes are silent as to whether or not co-employment is recognized. If legislation is passed, there is still the concern as to whether Montana's constitution in Article II, section 16, allows for more than one employer based on the usage of the term "immediate employer." However, it should be noted that the term "immediate employer" was originally inserted to address liability issues under 39-71-405.

However, if the co-employment statute is passed, the State Fund as a workers' compensation insurer also requests that additional provisions be inserted into the law as follows:

1. The experience modification factor of a client employer follows a client to the contractor. The experience modification factor of each individual client continues to be applied to the client each year and not just for the first year.

2. A volume discount for a contractor based on the aggregate payroll of all clients is optional and at the insurer's discretion.

3. That there be access to a client's premises for workplace inspections.

4. That both the client's records and the contractor's record be available for audit purposes and that the obligation for the Safety Culture Act be placed on both employers jointly.

5. The State Fund may refuse coverage for the client of an insured contractor if the client company (or any of its principals) have an unpaid obligation to the State Fund.

6. The same insurer shall cover a client's nonleased employees so as to avoid splitting of the risk.

The State Fund would support regulation of leasing companies as regulations may enhance the current protections offered in the statutes.

Please contact the State Fund if we can provide any additional information or assistance.

NB/df/bartlett.mem

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